NEGOTIABLE INSTRUMENTS

Negotiable Instruments — What Constitutes a Fictitious Payee

An agent for an insurance company in the settlement of claims against it, with authority to sign and execute drafts, executed drafts in favor of certain claimants but failed to deliver them. Instead he forged the signatures of the payees as endorsers, and collected on the drafts through his own bank. The plaintiff, after indemnifying the insurance company, sued the bank. It was held that the plaintiff might recover on the theory of money paid under mistake of fact.[1]

Under section 9(3) of the N. I. L.[2] an instrument is payable to bearer "when it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable." Unquestionably this rule was adopted to protect subsequent bona fide holders from the rigors of the forged indorsement rule, where the maker or drawer uses a fictitious payee in order to clothe the instrument with additional credit; still, it has been a prolific source of litigation in cases where an agent, having authority to draw in the name of his principal, forges the signature of the make-believe payee and uses the instrument for his own benefit.[3]

Whether the payee is a "fictitious person" within the meaning of the *act* so as to make the instrument payable to bearer is determined largely, if not altogether, by the intention of the one making the instrument, and not by the existence or non-existence of the payee.[4] Thus where the instrument is payable to an existing person but without intent that he should receive it, the payee is fictitious, within the rule.[5] On the other hand, where the instrument is payable to a non-existing person, believed to be existing, with the intent that he should receive it, the payee is not fictitious, within the rule.[6]

To what extent the presence or absence of an actual interest in the

[1] *Hartford Accident & Indemnity Co.* v. *First Natl. Bank*, 61 Ohio App. 217, 11 Ohio Op. 329 (1938).

[2] Ohio G.C. sec. 8114.

[3] Bigelow, Bills, Notes & Checks, (3d ed. 1928) p. 96.

[4] *Bourne* v. *Maryland Casualty Co.*, 185 S.C. 1, 192 S.E. 605 (1937); *Atlanta & L. Nat. Bank* v. *First Nat. Bank*, 38 Ga. App. 768, 145 S.E. 521 (1928); *Snyder* v. *Corn Exch. Nat. Bank*, 221 Pa. 599, 70 Atl. 876 (1908).

[5] *Choctaw Grain Co.* v. *First Nat. Bank*, 175 Okla. 458, 53 P. (2d) 579 (1936); *Norton* v. *City Bank & T. Co.*, 294 Fed. 839 (C.C.A. 4th), 74 A.L.R. 825 (1923); *Phillips* v. *Mercantile Nat. Bank*, 140 N.Y. 556, 35 N.E. 982 (1894).

[6] *McCormack* v. *Central State Bank*, 203 Iowa 833, 211 N.W. 542 (1926); *Caledonian Ins. Co.* v. *National City Bank*, 208 App. Div. 83, 203 N.Y.S. 32 (1924); *Fletcher American Nat. Bank* v. *Crescent Paper Co.*, 193 Ind. 329, 139 N.E. 664 (1923). *Contra*, *Kohn* v. *Watkins*, 26 Kan. 691, 40 Am. Rep. 336 (1882).

payee will affect the rule is not completely settled. If the payee is a real person who has a definite interest in the transaction, it is frequently implied that he cannot be a fictitious payee, regardless of the intention of the maker.[7] But in a case where this factor was present, no difficulty was experienced in finding that the instrument was payable to bearer.[8] However, where the payee has no definite interest but the maker intends that he should have such an interest he is not a fictitious payee.[9]

Who is the "person making it so payable" whose knowledge is essential to bring into operation section 9(3) of the N. I. L., so as to make the instrument payable to bearer? On its face, the phrase seems clear enough, and yet considerable conflict exists with respect to its interpretation. Some courts hold that it refers to the named maker or drawer,[10] while others hold that it refers to the person actually drawing the instrument.[11] Courts favoring the view that it is the named maker or drawer whose knowledge is required reach about the same result as courts favoring the other view, because they are willing, in the ordinary case, to impute this knowledge to the principal.[12] So it may be said, and practically all courts agree, that, in the absence of complicating factors, where an agent with authority to draw negotiable instruments draws a note, check or draft payable to a fictitious or non-existing payee and then endorses the name of such payee, the bank or person taking it for value will be protected on the theory that such an instrument is payable to bearer and so requires no indorsement to pass title.[13] A like result is reached where the agent is allowed merely to fill in the payee's name.[14] But if the agent, without authority to draw negotiable instruments, induces his principal to draw a note, check or draft payable to one whom the agent knows to be fictitious, the courts are in general accord in holding that the instrument is not payable to bearer and therefore

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[7] BIGELOW, BILLS, NOTES & CHECKS (3d ed. 1928) p. 97.

[8] *Bourne* v. *Maryland Casualty Co.*, 185 S.C. 1, 192 S.E. 605 (1937).

[9] *Rogers* v. *Ware*, 2 Neb. 29 (1873); *Hill* v *McCrow*, 88 Ore. 299, 170 Pac. 306 (1918). In the latter case the court gives the following example: "If A executes a negotiable promissory note to his neighbor B in payment for a brand of cattle agreed to be sold to A, which A is led to believe B owns, and if it should be found that in fact B did not own the cattle, that would not make B a fictitious or non-existing person."

[10] *American Hominy Co.* v. *National Bank of Decatur*, 294 Ill. 223, 128 N.E. 391 (1920); *American Sash & Door Co.* v. *Commerce Trust Co.*, 332 Mo. 98, 56 S.W. (2d) 1034 (1933); *Snyder* v. *Corn Exch. Nat. Bank*, 221 Pa. 599, 70 Atl. 876 (1908).

[11] *Goodyear Tire & Rubber Co.* v. *Wells Fargo Bank & Union T. Co.*, 1 Cal. App. (2d) 694, 37 P. (2d) 483 (1934); *Mueller & Martin* v. *Liberty Ins. Bank*, 187 Ky. 44, 218 S.W. 465 (1920).

[12] See note 10, *supra*.

[13] *Hartford Accident & Indemnity Co.* v. *Fifth Third Union Trust Co.*, 23 F. Supp. 53 (D.C. 1920); *Snyder* v. *Corn Exch. Nat. Bank*, 221 Pa. 599, 70 Atl. 876 (1908); *Phillips* v. *Mercantile Nat. Bank*, 140 N.Y. 556, 35 N.E. 982 (1894).

[14] *Rancho San Carlos* v. *Bank of Italy Nat. Trust & Savings Assoc.*, 123 Cal. App. 291, 11 P. (2d) 424 (1932).

requires a bona fide indorsement to pass title.[15] Feeling, perhaps, that it would be more just to protect the subsequent holder in this type of case, several states have broadened their statutes to take care of this situation.[16] Moreover, a recent California case, dealing with a comparable situation, adopted a more liberal view. In that case an employee of one of the bank's depositors purchased cashier's checks and prevailed upon the bank to make them payable to an actual person whom he intended to have no interest in them, and the court held that the checks were payable to bearer.[17]

A complicating factor in some of the cases has been the necessity of having more than one individual sign the note or draft. This would seem to make more difficult the application of the rules heretofore considered with respect to cases where the named maker or drawer is a different person from the one actually drawing the instrument. Especially is this true under the view that the knowledge or intent of the person actually drawing the instrument is controlling, for there it appears logical to require all signers to have a similar interest.[18] Furthermore, the requirement for more than one signature is used in most instances as a safeguard against fraudulent agents. Oddly enough, in the few instances in which this problem has come up, the courts have taken the view that the fraudulent intent of one of two co-signers is sufficient to render the instrument payable to bearer.[19]

As in many other situations arising under the N. I. L., the question here is as to which one of two innocent parties will be called upon to sustain a loss due to the fraudulent act of some third party. Likewise, as in other situations, the courts appear to be willing to mitigate the hardship which may result from an arbitrary application of the rule by introducing additional restrictions on its operation. Just as the fictitious payee rule modifies the forged indorsement rule, so the rule which favors the party least at fault offsets any unfairness which may result from the operation of the fictitious payee rule.

The principal case offers an excellent example of this technique.

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[15] *Commonwealth* v. *Globe Indemnity Co.*, 323 Pa. 261, 185 Atl. 796 (1936); *Metropolitan Casualty Ins. Co.* v. *First Nat. Bank*, 261 Mich. 450, 246 N.W. 178 (1933); *Egner* v. *Com. Exch. Bank*, 42 Misc. 552, 86 N.Y.S. 107 (1904). See also *Jones & Sons* v. *Peoples Bank Co.*, 14 Ohio N.P. (N.S.) 129 (1913), reversed on other grounds in 95 Ohio St. 253, 116 N.E. 34 (1917).

[16] Ill. Rev. Stat. (1937), c. 98 sec. 29 (3); Iowa Code (1932), sec. 26-109 (3); Mont. Rev. Code 1935, sec. 8416 (3).

[17] *Union Bank & Trust Co.* v. *Security First Nat. Bank*, 93 Cal. Dec. 174, 65 P. (2d) 355 (1937). Note (1937) 25 Cal. L. Rev. 616.

[18] 83 U. Pa. L. Rev. 678 (1935).

[19] *Bourne* v. *Maryland Casualty Co.*, 185 S.C. 1, 192 S.E. 605 (1937); *Goodyear Tire & Rubber Co.* v. *Wells Fargo Bank & Union T. Co.*, 1 Cal. App. (2d) 694, 37 P. (2d) 483 (1934).

The court emphasizes the fact that the drafts in question were not ordinary drafts in that they contained statements of their purpose to release claims against the insurance company, and that the fraudulent agent was a regular depositor in the defendant bank. The court then says: "It does not seem to us a sufficient answer to all this to say that, within the meaning of the Negotiable Instruments Act the drafts were payable to fictitious payees, even assuming such to be the legal effect of what was done." While it might be argued that the provision for release in the drafts was for the purpose of protecting the insurance company from further liability on the same claims, and not to protect it against forgery, the presence of such a provision furnished additional evidence of negligence on the part of the defendant.

Viewed in this light there can be no doubt but that the court was seeking to perform substantial justice, and it probably succeeded. And this is none the less true because a different result was reached in a case in the federal court with respect to the same sort of drafts,[20] for the attending facts in that case were such as to negative any claim of negligence on the part of the defendant. W. L. A.

PROCEDURE

Procedure — Province of Court and Jury in Action Against Corporations for Torts of Statutory Police Employees

In a recent federal case, *Erie Railroad* v. *Johnson*,[1] plaintiff sued the defendant railroad company alleging an assault and battery, false imprisonment, and malicious prosecution by three railroad police officers commissioned by the Governor and compensated by the defendant, pursuant to sections 9150 and 9151 of the Ohio General Code. The latter section provides "policemen so appointed, and commissioned severally shall possess and exercise the powers, and be subject to the liabilities of policemen of cities in the several counties in which they are authorized to act while discharging the duties for which they are appointed." Plaintiff's evidence tended to show that the three police officers, one of whom was a lieutenant, while investigating a reported theft of railroad propery, discovered plaintiff in an abandoned garage of an oil company, where he was seeking shelter from the rain; they

[20] *Hartford Accident & Indemnity Co.* v. *Fifth Third Union Trust Co.*, 23 F. Supp. 53 (Ohio 1938). Note (1939) 6 Un. of Chi. L. Rev. 700.

[1] *Erie R.* v. *Johnson*, 106 F. (2d) 550 (1939).